

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLEE**

77-6012

[Printed Version]

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee-Cross-Appellant,

v.

PARKLANE HOSIERY CO., INC.
HERBERT N. SOMEKH,

Defendants-Appellants-Cross-Appellees.

Appeal from the United States District Court for
the Southern District of New York

OPENING BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION

PAUL GONSON
Associate General Counsel

DANIEL L. GOELZER
Special Counsel

EDWARD A. SCALLET
Attorney

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

INDEX

	<u>Page</u>
CITATIONS	ii
PRELIMINARY STATEMENT	1
ISSUE PRESENTED	3
STATUTES AND RULES INVOLVED	3
STATEMENT OF THE CASE	4
A. FACTS	4
Parklane and its \$2.7 million sale of shares to the public	4
The Spring of 1974 — the banks pressure Somekh for re- payment of over \$1 million of personal loans un- related to Parklane	4
The plan to turn Parklane into a privately-held company	7
The aftermath — Somekh raids the Parklane treasury	12
B. The Proceedings Below	14
ARGUMENT	17
IN LIGHT OF THE INDIVIDUAL DEFENDANT'S LACK OF CANDOR BEFORE THE DISTRICT COURT, AND THE NATURE OF THE VIOLATIONS WHICH THE DISTRICT COURT FOUND, RELIEF AGAINST FUTURE VIOLATIONS SHOULD HAVE BEEN GRANTED IN THIS CASE	17
A. The Record In This Case Demonstrates the Need For Injunctive Relief	17
1. Somekh's testimony in the court below	18
2. The intentional nature of Somekh's conduct	23
B. The District Court Misjudged the Probability of Future Violations	25
CONCLUSION	33

CITATIONS

<u>Cases:</u>	<u>Page</u>
Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972)	27
Bradford v. Securities and Exchange Commission, 278 F.2d 566 (C.A. 9, 1960)	26
Green v. Santa Fe Industries, ___ U.S. ___, 45 U.S.L.W. 4317 (March 23, 1977)	2
Gulf & Western Industries, Inc. v. Great Atlantic & Pacific Tea Companies, Inc., 476 F.2d 687 (C.A. 2, 1973)	27
Hillsborough Investment Corp. v. Securities and Exchange Commission, 276 F.2d 665 (C.A. 1, 1960)	31
J. I. Case Co. v. Borak, 377 U.S. 426 (1964)	27
Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission, 285 F.2d 162 (C.A. 9, 1960), <u>certiorari denied</u> , 366 U.S. 919 (1961)	17
Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970)	27
Mitchell v. Pidcock, 299 F.2d 281 (C.A. 5, 1962)	26,31
NLRB v. Express Publishing Co., 312 U.S. 426 (1941)	31
NMU v. Commerce Tankers Corp., 457 F.2d 1127 (C.A. 2 1972)	25
Otis & Co. v. Securities and Exchange Commission, 106 F.2d 579 (C.A. 6, 1939)	18
People v. Concord Fabrics, Inc., 371 N.Y.S. 2d 550 (Sup. Ct., 1975), <u>affirmed</u> , 373 N.Y.S. 2d 84 (App. Div. 1st Dept., 1976)	24
Securities and Exchange Commission v. Advance Growth Capital Corp., 470 F.2d 40 (C.A. 7, 1972)	26
Securities and Exchange Commission v. Boren, 283 F.2d 312 (C.A. 2, 1960)	17
Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963)	27,30
Securities and Exchange Commission v. Culpepper, 270 F.2d 241 (C.A. 2, 1959)	17,32

<u>Cases (continued):</u>	<u>Page</u>
Securities and Exchange Commission v. First American Bank & Trust, Co., 481 F.2d 673 (C.A. 8, 1973)	18
Securities and Exchange Commission v. Geon Industries, Inc., 531 F.2d 39 (C.A. 2, 1976)	31
Securities and Exchange Commission v. Graye, 156 F. Supp. 544 (S.D. N.Y., 1957)	31,32
Securities and Exchange Commission v. Keller Corp., 323 F.2d 397 (C.A. 7, 1963)	17
Securities and Exchange Commission v. MacElvain, 417 F.2d 1134 (C.A. 5, 1969), <u>certiorari denied</u> , 397 U.S. 972 (1970)	18
Securities and Exchange Commission v. Management Dynamics, Inc., 515 F.2d 801 (C.A. 2, 1975)	17,25,30
Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F.2d 1082 (C.A. 2, 1972)	17,31
Securities and Exchange Commission v. Midwest Technical Development Corp., [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,252 (D. Minn., 1963)	29
Securities and Exchange Commission v. North American Research & Development Co., 375 F. Supp. 465 (S.D. N.Y., 1974)	31
Securities and Exchange Commission v. Scott, Gorman Municipals, Inc., 407 F. Supp. 1383 (S.D. N.Y., 1975)	31
Securities and Exchange Commission v. Shapiro, 494 F.2d 1301 (C.A. 2, 1974)	17,30
Securities and Exchange Commission v. Tax Service, Inc., 357 F.2d 143 (C.A. 4, 1966)	26
Securities and Exchange Commission v. Universal Major Industries Corp., 546 F.2d 1044, 1048 (1976)	17,18,23
State v. Whittaker, 118 Ore. 656, 247 P. 1077 (1926)	31

Cases (continued):

Page

Stonemets v. Head, 248 Mo. 243, 154 S.W. 108 (1913)	31
Tanzer v. Huffines, 408 F.2d 42 (C.A. 3, 1969)	17
Tcherepnin v. Knight, 389 U.S. 332 (1967)	27
United States v. Diapulse Corp. of America, 457 F.2d 25 (C.A. 2, 1972)	26,27
United States v. E.I. Du Pont de Nemours & Co., 366 U.S. 316 (1961)	3
United States v. Parke, Davis & Co., 362 U.S. 29 (1960)	26
Walling v. Helmerich & Payne. Inc., 323 U.S. 37 (1944)	18

Statutes and Rules:

Securities Act of 1933, 15 U.S.C. 77a et seq.:

Section 17(a), 15 U.S.C. 77q(a)	14
---------------------------------------	----

Securities and Exchange Act of 1934, 15 U.S.C. 78a et seq.:

Section 10(b), 15 U.S.C. 78j(b)	14
Section 12(b), 15 U.S.C. 78l(b)	4
Section 13(a), 15 U.S.C. 78m(a)	4,14
Section 14(a), 15 U.S.C. 78n(a)	4,14,23
Section 21(d), 15 U.S.C. 78u(d)	3,14
Section 32, 15 U.S.C. 78ff	28

Statutes and Rules (continued):

Page

Rules under the Securities Exchange Act of 1934:

Rule 10b-5, 17 CFR 240.10b-5	14
Rule 13a-1, 17 CFR 240.13a-1	14
Rule 13a-13, 17 CFR 240.13a-13	14
Rule 14a-3, 17 CFR 240.14a-3	14
Rule 14a-9, 17 CFR 240. 14a-9	14

Miscellaneous:

Annual Report of the Securities and Exchange Commission Tables 28, 29 (1975)	28
H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13-14 (1934)	23
H.R. Rep. No. 6789, 88th Cong., 1st & 2d Sess. 165 (1964)	23
H.R. Rep. No. 6793, 88th Cong., 1st & 2d Sess. 165 (1964)	23
S. Rep. No. 792, 73d Cong., 2d Sess. 12 (1934)	23
S. Rep. No. 1642, 88th Cong., 1st & 2d Sess. 165 (1964)	23
2 L. Loss, Securities Regulations, 1027 (2d ed., 1961)	23

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 77-6012

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee-Cross-Appellant,

v.

PARKLANE HOSIERY CO., INC.
HERBERT N. SOMEKH,

Defendants-Appellants-Cross-Appellees.

Appeal from the United States District Court
for the Southern District of New York

OPENING BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION

PRELIMINARY STATEMENT

This is an appeal 1/ by the plaintiff Commission from a judgment entered by the United States District Court for the Southern District of New York (Kevin Duffy, J.) on March 9, 1977 (A30 - A32).2/ The lawsuit arose out of a scheme engineered by the individual defendant, Herbert N. Somekh, to freeze out the public shareholders of the other defendant, a corporation under his control, Parklane Hosiery Co., Inc. The purpose of this maneuver, as the

1/ The defendants have appealed from that portion of the district court's order which requires them to correct certain filings made with the Commission. Subsequent to that appeal, the Commission filed its notice of appeal from the district court's denial of injunctive relief. On April 4, 1977, this Court expedited the appeal and ordered that simultaneous opening briefs be filed on or before April 29, 1977, and that answering briefs be filed on or before May 13, 1977.

2/ Pages of the joint appendix filed with this Court are cited as "A ____". Judge Duffy's Opinion and Order was rendered on November 9, 1976, and is reported at 422 F. Supp. 477; it is reprinted at A4 - A26. A supplemental order amending the March 9 Judgment was entered on March 23, 1977 (A33 - A34).

district court found, was to clear the way for Somekh to raid Parklane's treasury in order to pay his personal debts. In connection with this scheme, Parklane disseminated a proxy statement to its public shareholders which the court below found to be materially false and misleading in three critical respects.^{3/}

After a four-day evidentiary hearing in which Somekh, as the only witness for the defendants, testified extensively as to his version of the relevant events, the court entered its findings of fact. These were contrary to Somekh's assertions on several key points. The court held that defendants had knowingly violated the proxy, antifraud, and periodic reporting requirements of the Securities Exchange Act and the Commission's rules thereunder. As a result, the court ordered that the defendants correct the fraudulent filings they had made or caused to be made with the Commission. The decree, however, also denied the Commission's request for permanent injunctive relief barring the defendants from further violations of the antifraud, reporting, and proxy solicitation provisions of the federal securities laws, and the Commission has appealed from this aspect of the district court's order.

The Commission is aware that it carries a heavy burden when it attempts to overturn a determination regarding the proper scope of relief. The Commission believes, however, in light of the facts which the Commission established at trial and which the district judge found, that the court below erred in its denial of injunctive relief in this case. As the Supreme Court has recognized in the analogous context of relief under another remedial federal statute: "the suit has been a futile exercise if the Government proves a violation but fails to secure a remedy

^{3/} The Commission did not allege that Somekh's plan to transform Parklane from a publicly-held company to private status constituted a violation of the federal securities laws. Cf., Green v. Santa Fe Industries, U.S., 45 U.S.L.W. 4317 (March 23, 1977). Rather, the Commission alleged and proved that the defendants had engaged in the dissemination of fraudulently deceptive proxy materials.

adequate to redress it." 4/ The Commission respectfully urges that this Court reverse the district court and direct the entry of a permanent injunction restraining the defendants from further violations of those provisions of the federal securities laws which they knowingly violated in the instant case.

ISSUE PRESENTED

Whether the district court erred in denying the plaintiff Securities and Exchange Commission injunctive relief against further violations of the federal securities laws by defendants Herbert N. Somekh and Parklane Hosiery Company, when:

- the court found that the defendants had knowingly violated those laws by disseminating a proxy statement that was found to be materially false and misleading;
- the record demonstrates that the individual defendant's lack of candor concerning the events in question persisted through his testimony at trial; and
- the nature of the individual defendant's violations suggest that, without the aid of the remedial relief of an injunction, he is likely to repeat his violative conduct.

STATUTES AND RULES INVOLVED

The statutory provision relevant to the Commission's cross-appeal is Section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(d), which provides, in pertinent part:

"Wherever it shall appear to the Commission that any person is engaged or is about to engage in any acts or practices constituting a violation of any provision of this title [or] the rules or regulations thereunder, * * * it may bring an action in the proper district court * * * to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond."

4/ United States v. E.I. Du Pont de Nemours & Co., 366 U.S. 316, 323 (1961).

STATEMENT OF THE CASE

A. Facts

Parklane and its \$2.7 million sale of shares to the public

In 1968, Parklane sold 300,000 shares of common stock to the public at \$9 per share (A38). This stock was subsequently listed and traded on the American Stock Exchange (A38), and, accordingly, Parklane became subject to the periodic reporting and proxy solicitation provisions of the Securities Exchange Act of 1934. See Sections 12(b), 13(a), and 14(a) of the Act, 15 U.S.C. 78l(b), 78m(a), 78n(a). At the time of this public offering, and up until the events which form the background for this lawsuit, Parklane was engaged almost exclusively in the retailing of items such as women's hosiery, gloves, and costume jewelry (A39). In 1974, when the events involved in this litigation occurred, the company had total assets of \$9.5 million and its sales were approximately \$22 million (A511). Defendant Somekh has been President and Chairman of the Board of Parklane from its inception in 1946 until the present (A39). Together with certain insiders of Parklane and with persons associated with him, Somekh in 1974 owned 71.6 percent of the outstanding shares of Parklane — there were approximately 750 public shareholders (A506). In addition to his position at Parklane, however, Somekh is a substantial investor in various other ventures (A481 - A483).

The Spring of 1974 -- The banks pressure Somekh for repayment of over \$1 million of his outstanding personal loans unrelated to Parklane

The events which give rise to this litigation resulted from the precarious financial position in which Parklane's chief executive, Somekh, found himself in 1974. This financial crisis was set in motion in 1971 when Somekh approached Banker's Trust Company ("Banker's Trust"), about extending loans to both Parklane and Somekh and his wife (A61 - A62, A132). After an investigation, the bank made a loan of \$750,000 to Parklane and a separate loan of \$900,000 to the Somekhs (A62, A132). This latter loan was unrelated to Parklane and was for the personal benefit of Somekh to enable him to conduct his other investment

enterprises (A132). Somekh personally guaranteed both of these loans (A104, A132), and collateralized each with the Parklane stock held by Mr. and Mrs. Somekh, various other equity securities, and the assignment or mortgaging of several real estate properties held by Somekh, including land in Tulsa, Oklahoma and land in New Jersey (A63-A64).

From the inception of the loan in 1971 until August, 1974, the Somekhs made only one \$80,000 payment on their personal loan and Parklane made no payments at all on its loan (A64). As a result, Banker's Trust began to pressure Somekh for repayment. At a meeting in January, 1974, Mr. Thomas Baggott ("Baggott"), a vice-president of Banker's Trust, met with Somekh and indicated that the bank was becoming restive and needed some assurance that the loan would be repaid (A67). Somekh replied that he could possibly mortgage his home and that he could also sell a mortgage note he held on a drug store (A68). Baggott reiterated the bank's position that it wanted repayment and suggested that Somekh go beyond whatever efforts he had made to that point (A67).

During the next month, Banker's Trust continued to exert pressure on Somekh in the form of letters from Baggott to Somekh, stating in one letter, for example, that "I [Baggott] would appreciate very much if you would have this letter serve as a reminder to you that I would like some clear cut action on * * * [the personal loan] in the immediate future" (A534, A535). Somekh responded with letters to Baggott in which he outlined steps he was taking on the house mortgage and on collection of the drug store note (A537, A540). He also mentioned a possible deal for the sale of his real estate in Tulsa (A540). In March, 1974, Baggott met again with Somekh to exert further pressure

on him to reduce his personal loan (A73, A136 - A137). Somekh reiterated the possibility of a mortgage on his personal residence and a sale of the drug-store note (A75). He also indicated, however, that the deal concerning the Tulsa property had not been consummated (A75).

This pattern continued over the next several months. Baggott continued to press for immediate payment of the loan (A543), while Somekh countered by dangling the prospect of selling some of his holdings (A542). The real estate market had, however, become depressed and, as a result, no properties were sold and no payments were made on the personal loan before the decision to convert Parklane to a private company (A88).

During the same period that Banker's Trust was pressuring Somekh, his financial woes were further exacerbated as a result of dunning from another quarter -- National Bank of North America ("National Bank"). That institution demanded payment of a \$150,000 loan it had made in late 1970 to "433 JV", a real estate partnership (unrelated to Parklane) of which Mr. Somekh was a partner (A323, A324). The loan was secured by the stock of various cooperative apartments and was personally guaranteed by Somekh (A321). Somekh originally contemplated repayment of this loan within nine months through the sale of stock in the cooperative apartments, but the anticipated sale failed to materialize (A323).

On July 13, 1973, National Bank wrote to Harold Strauss, one of Somekh's partners in 433 JV, requesting payment on the loan or the recasting of it, and on February 21, 1974, the bank sent a similar letter to Somekh (A546). When no response was forthcoming, Mr. Richard D. Tunick, an officer of National Bank, wrote to Somekh on May 15, 1974, demanding immediate repayment of the loan or "the matter will be turned over to our attorneys for collection * * * " (A546). This position was reaffirmed in a meeting between Tunick and

Somekh on or about May 26, 1974 (A165, A329). Tunick reiterated that the bank had expected immediate repayment of its loan and had, in consequence, made the sale at fixed interest (A323). As a result, the bank was losing money and now wanted the obligation discharged (A323). Alternatively, Tunick suggested that the loan could be refinanced through a corporate vehicle, since this would allow the bank to charge a much higher rate of interest (A332 - A333). In response, Somekh replied only that he was extremely illiquid and could not repay the loan (A323).

The final blow fell when a third bank entered the chase for Somekh's limited assets. On March 4, 1974, First National City Bank ("City Bank") notified Somekh that it could no longer carry a \$125,000 loan which it had extended to Somekh (A545). Somekh made no response, and, on July 23, 1974, the bank informed him that it was calling that loan and would take legal action if it was not paid by August 5 (A548).

The plan to turn Parklane into a privately-held company

To reiterate, the Spring of 1974 was a tense time for Somekh. Three separate banks were demanding repayment of loans totaling \$1,175,000. The real estate market was depressed and he could not sell his holdings. Further extensions of credit were unlikely -- besides the \$1,175,000 demanded by the banks, he had personally guaranteed millions of dollars more in various loan transactions involving business entities, primarily real estate shells, with which he was affiliated (A132). Finally, Somekh could not even look to Parklane dividends for help -- hosiery consumption had dropped dramatically in the last several years and the business was becoming more and more risky (A434).

In the midst of this crisis, Somekh hit upon a plan which offered him a way out -- the transformation of Parklane into a privately-held company. Somekh first discussed going private with a member of the accounting firm

that handled his personal account sometime in June (A50), and later that month or in early July, he discussed the matter several times with the law firm which represented him (A124). By July 26, 1974, the idea had progressed to the point where he presented it to Parklane's board of directors (A552).

At the first meeting of the board of directors in which the idea of going private was presented, no reasons were given to the board as to why the company should suddenly terminate its publicly-held status (A174 - A175). Somekh was authorized, however, to retain two independent appraisers to value Parklane's stock (A552). During the next month, a plan was devised by Somekh and his lawyers, and, on August 27, 1974, Somekh and the group associated with him took their first step toward changing the corporate status of Parklane by forming another corporation, New PLHC Corp. ("PLHC") (A505). Somekh and his associates thereafter transferred their equity ownership of Parklane to PLHC (A42).

At this point, the proposed proxy statement was prepared to solicit the public shareholders' votes on a merger of Parklane and PLHC and to offer those shareholders \$2 per share for their Parklane stock (A505). This proxy, however, presented several problems. The first concerned the reasons for the going-private scheme — under the heading, "Purpose and Background of Proposed Merger" the following ambiguous statement appeared:

"If the proposed merger is consummated, the shareholders of Newco [PLHC] will be entitled to the benefit of all the assets, earnings, earning capacity and cash flow of the Company [Parklane]. The merger will make possible a combination of the resources of the Company with those of Mr. Somekh (who with his wife and trusts for the benefit of his children, owns approximately 86 percent of the stock of Newco) for the conduct of real estate activities of the type that Mr. Somekh has to date conducted individually (primarily development of garden apartments). Such a combination is presently being contemplated." (A507)

A second problem concerned the required disclosure relating to a leasehold interest held by Parklane. Sometime in 1957-1958, Parklane had leased property at 68-70 Nassau Street, New York City ("Nassau Street") (A238). It originally operated its own store there, but subsequently divided the premises (A228 - A229). One-half of the location was leased to a delicatessen, while Parklane maintained its operation in the other half (A229). In the 1960's, Parklane franchised its half of the property to two persons (A229). This piece of property later became quite valuable, for, in 1968, the Federal Reserve Bank of New York ("FRB") decided to expand its operations and purchased the Nassau Street block (A341).

In 1969, FRB, through an agent, Robert I. Curtiss, began to negotiate for the purchase of the Nassau Street lease held by Parklane (A359). Throughout the next several years, various discussions were held concerning the leasehold (A369, A371). On October 9, 1973, FRB made an offer of \$800,000 to Parklane in return for releasing its lease, but the offer was not accepted. In 1974, however, negotiations about the leasehold were reactivated when, on March 21, 1974, FRB offered \$500,000 for the cancellation of the leasehold (A442), and on May 16, 1974, it upped the ante to \$800,000 (A385, A576).

Any sale of Parklane's leasehold also required some disposition of the rights of the sub-tenant and franchisee. The delicatessen sub-tenant was demanding \$800,000 for the release of its interest alone (A489), while the franchisee was demanding \$300,000 (A386). On June 13, 1974, a breakthrough occurred in the negotiations when the delicatessen sub-tenant reduced its demand to \$600,000 (A497). Accordingly, on June 27, 1974, Parklane made a counter-offer of \$1.2 million for the cancellation of the leasehold (A245). Although there was correspondence between Somekh and Curtiss about the counter-offer during July, it expired without any action (A392).

On September 29, 1974, the time the proxy solicitation was originally prepared and filed with the Commission, the Nassau Street negotiations had apparently ceased and the proxy statement reflected that status (A519). But, on October 4, 1974, the negotiations resumed when Somekh and Curtiss met again to discuss the leasehold cancellation (A247, A338). It was agreed between the two men that a figure of \$1.2 million was fair since \$600,000 was satisfactory for the interests of Parklane and its franchisee and \$600,000 was being sought by the delicatessen sub-tenant (A340). Curtiss stated that he would recommend to FRB a payment of \$1.2 million, and, in return, Somekh would get assurances from the sub-tenant and the franchisee to accept the amounts settled upon by the two negotiators (A343). That same afternoon, Curtiss recommended the \$1.2 million figure to FRB (A339). FRB responded that it was having some problems with its new building and that it might have to reconsider its negotiating terms (A347). Nonetheless, Curtiss wrote to FRB on October 7 reiterating the substance of the October 4 negotiations with Somekh (A571 - A573).

Somekh talked with Curtiss within the week and indicated his desire to terminate the negotiations with an agreement (A347 - A348). On October 29, 1974, Somekh wrote to Baggott at Banker's Trust, stating that he did not yet have any deals, but that he had had several conversations about cancellation of the leasehold and that Parklane could net \$300,000 from the negotiations (A575).

Notwithstanding this change in the status of the Nassau Street negotiations, no amendment to the proxy statement was made. Thus, at the time of Parklane's October 14, 1974 annual meeting to which the proxy solicitation applied, the public shareholders, in evaluating their decision to accept or reject the \$2 per share offering price, were not aware that 10 days earlier a

significant development had occurred in a business venture that could have materially enhanced Parklane's financial situation. As noted above, consummation of the leasehold deal would have produced a \$300,000 cash infusion for Parklane. By comparison, Parklane's net earnings for all of fiscal 1973 were \$523,000 (A511).

The third disclosure problem revolved around the appraisal of Parklane's shares. As noted, at the July 26, 1974 meeting of Parklane's board of directors, Somekh was directed to retain two independent appraisers to evaluate the Parklane stock (A552). On August 12, 1974, Somekh retained the firm of Thomson & McKinnon, Auchincloss, Kohlmeyer ("Thomson & McKinnon") to conduct an appraisal. On September 3, 1974, Thomson & McKinnon reported its results to Parklane and assigned a value of approximately \$1.75 per share (A194, A303). The book value of Parklane's shares was approximately \$4.45 at that time (A509); investors in the 1968 public offering, in contrast, paid \$9 per share (A 38).

In connection with that appraisal proceeding, the appraiser examined Parklane's annual reports, its budget for the 1974 fiscal year and the budget for fiscal year 1975 (A304). Basically, the technique was to evaluate (1) the present net worth of Parklane's assets, (2) the future earnings of the company based upon an analysis of Parklane's future business, and (3) the cash flow potential the company could be expected to produce over the next three years (A306). The appraiser for Thomson & McKinnon, however, was not told that Somekh was going to use Parklane's assets to pay off his personal debts by purchasing his property, thereby altering the nature of Parklane's business from primarily a specialty retail company to a company with substantial real estate holdings (A306, A308). The appraiser testified that, had he known this fact, it would have affected his appraisal since, as noted, two of

the three factors used by the appraiser were dependent upon an analysis of Parklane's future cash flow and business (A308). Moreover, the appraiser was not told about the negotiations for the cancellation of the leasehold, or the fact that Parklane could net \$300,000 from those negotiations (A304 - A310). Had the appraiser known this fact, it too, would have affected his appraisal (A310).

At the August 29, 1974 meeting of the Board of Directors, one of the directors argued that the \$2 per share price offered to the public shareholders (many of whom had paid \$9 for their shares in the 1968 public offering) was unfair (A556). Somekh, however, stressed the Thomson & McKinnon appraisal, and the board voted to offer \$2 per share (A555).

On September 25, 1974, all holders of Parklane stock other than the insider-shareholders of PLHC were offered either \$2 in cash per share or, if the shareholder dissented from the merger, the amount set in an appraisal proceeding provided under New York state law for dissenters (A43). On October 14, 1974, pursuant to a vote at the annual meeting, PLHC was merged into Parklane, and, as a result, no public shareholders retained any interest in the company thereafter (A44 - A45).

The aftermath -- Somekh raids the Parklane treasury

In August, 1974, after Somekh had conceived the going private scheme, he met again with Mr. Baggott of Banker's Trust to discuss his large outstanding indebtedness (A89, A203). Rather than repeating his previous promises to sell some of his property on the market, however, Somekh unveiled his new plan. He told Baggott that he had decided to go private as a means of liquidating his personal obligations (A89). He said that, after the outside stockholders were eliminated, he could sell some of his properties to the new company (A89 - A90).

On September 5, 1974, Baggott and Somekh held another meeting (A93, A210). At this time, Somekh detailed exactly how he planned to reduce his personal indebtedness by going private (A94). He stated that certain notes would be sold to the new private company; a note would be given by the new private company to him; that, in connection with the note, the new private company would pay him; and, finally, that he would pay out his personal obligation from the note proceeds (A94).

After the plan to eliminate the public shareholder had been set in motion, Somekh took several immediate steps to help reduce his personal indebtedness. On September 16, 1974, Somekh, as one of the three members of an executive committee of Parklane, voted himself a substantial raise in salary from \$90,000 to \$150,000, and made that change retroactive for the whole preceding year (A218, A221). Soon thereafter, on December 30, 1974, Somekh executed his plan by causing Parklane to purchase his New Jersey property in exchange for a note of \$300,000 (A564, A566). On that same date, he also caused the company to buy 97 percent of his interest in the Tulsa property (A566). The total price for this purchase was \$778,500 (A566).

Armed with his increased salary and notes from Parklane from the sale of the properties, Somekh rapidly began to pay off his personal indebtedness. In November, 1974, he discharged the National Bank loan (A231). His first increased salary check was applied to the Banker's Trust loan (A234 - A235). Moreover, starting January 1, 1975, Parklane paid Somekh \$25,000 per month, which he, in turn, used to reduce his loan at Banker's Trust (A235). The debt to City Bank, which had finally sued for its money, was settled by an agreement to pay the bank \$4,000 per month (A224). This was paid from the proceeds of a note from Parklane to Somekh for \$4,000 per month (A235). In all, from the date of the merger to the time of trial, Parklane paid Somekh over \$1 million in salary and for his properties (A232).

B. The Proceedings Below

The Commission brought this action pursuant to Section 21(d) of the Securities Exchange Act, 15 U.S.C. 78u(d), on May 5, 1976, to enjoin defendants Parklane and Somekh from further violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), Sections 10(b), 13(a) and 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), 78m(a) and 78n(a), and Rules 10b-5, 13a-1, 13a-13, 14a-3 and 14a-9 thereunder, 17 CFR 240.10b-5, 240.13a-1, 240.13a-13, 240.14a-3, and 240.14a-9 (A580 - A589). ^{5/} The Commission alleged generally that the defendants had filed or caused to be filed with the Commission a proxy statement that was disseminated to the public shareholders of defendant Parklane for the purpose of securing their votes to authorize the conversion of Parklane to a privately-owned company, which statement was alleged to be materially false and misleading in three respects (A587):

- (1) the proxy statement failed to disclose the true reason behind Parklane's conversion from a publicly-held to a privately-held company, which was to enable the defendant Somekh to repay his massive personal indebtedness;
- (2) the unamended proxy statement was false when it stated that there were no negotiations between Parklane and the FRB over the cancellation of a leasehold held by Parklane, when, in fact, Somekh had had a meeting with the chief negotiator for the FRB just after the effective date of the proxy statement and just before the meeting for which the proxies were being solicited;

^{5/} Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder are commonly referred to as the antifraud provisions of the federal securities laws. Generally speaking, they prohibit the use of fraudulently misleading representations in the purchase or sale of securities. Section 13(a) of the Securities Exchange Act and the rules thereunder require the filing of various annual and periodic reports with the Commission reflecting the current financial position of the issuer and other material information. Implicit in these requirements is the proposition that these reports not be materially false and misleading. Section 14(a) of the Securities Exchange Act and the rules thereunder police the proxy solicitations of public corporations to insure that, among other things, shareholder proxies are not obtained on the basis of materially false and misleading information.

- (3) the proxy statement was materially false and misleading when it stated that an independent appraiser had valued a share of Parklane's common stock between \$1.70 and \$1.85, but failed to disclose that that appraisal had been conducted without the benefit of several crucial pieces of information.^{6/}

A four-day evidentiary hearing commenced before Judge Duffy on June 2, 1976. The witnesses at the hearing were Somekh, his bankers, the negotiator for the FRB, and an individual who had been employed by Parklane to appraise its stock. On November 9, 1976, the district court rendered its Opinion and Order in which it found that the defendants had knowingly violated the federal securities laws in the three respects urged by the Commission (422 F. Supp. at 487; A26). Although the court ordered the defendants to correct the erroneous filings which they had made with the Commission, and which the court had found to be false and misleading, the court declined to grant any of the other injunctive or ancillary relief sought by the Commission (422 F. Supp. at 487; A26). ^{7/} A judgment effectuating the decision was entered on March 9, 1977 (A30 - A32), and amended on March 23, 1977 (A33 - A34). ^{8/}

^{6/} The Commission also alleged that Parklane's annual report on Form 10-K, filed on or about July 10, 1975, and its quarterly report on Form 10-Q, filed on or about October 23, 1975, were materially false and misleading in the same three respects (A588).

^{7/} The Commission also requested that a Special Counsel be appointed to conduct an independent appraisal of Parklane's stock (A593). The court declined to order this relief, reasoning that the state court appraisal proceeding for the dissenters to the merger was adequate (422 F. Supp. at 486; A25). The Commission does not challenge that determination on appeal.

^{8/} On January 7, 1977, the defendants filed a notice of appeal from the findings and conclusions of the district court's November 9 Opinion and Order, and on January 21, 1977, the Commission filed a notice of cross-appeal from the denial of injunctive relief. On January 20, 1977, since more than two months had elapsed from the time the district court had ordered the defendants to correct their filings, the Commission moved the district court for an order compelling the defendants to comply with the court's previous order.

At this point, the defendants, for the first time, interposed an objection in the district court based upon the fact that no separate judgment had

(footnote continued)

Defendants Parklane and Somekh filed a notice of appeal on March 10, 1977, seeking review of the district judge's findings and conclusions with respect to their violations (A595). Once the defendants had brought the case to this Court, the Commission, on March 23, 1977, filed its notice of cross-appeal seeking review of the court's refusal to grant injunctive relief (A596).

8/ (footnote continued)

been entered embodying the unambiguous mandate set forth in the November 9 Opinion and Order. On January 31, 1977, the district court ordered that the amendments to Parklane's filings be made by February 4, 1977. Prior to that time, however, the defendants moved this Court for a stay of the district court's November 9 and January 31 orders, and on February 8, 1977, this Court, without reaching the question of a stay, remanded the case to the district court for entry of a separate judgment. Thereafter, on March 9, 1977, the district court entered a judgment, and denied a stay pending appeal; by order of April 4, 1977, this Court granted a stay pending appeal but also expedited the appeal.

ARGUMENT

IN LIGHT OF THE INDIVIDUAL DEFENDANT'S LACK OF CANDOR BEFORE THE DISTRICT COURT, AND THE NATURE OF THE VIOLATIONS WHICH THE DISTRICT COURT FOUND, RELIEF AGAINST FUTURE VIOLATIONS SHOULD HAVE BEEN GRANTED IN THIS CASE.

A. The Record In This Case Demonstrates the Need For Injunctive Relief.

This Court has held that "[t]he critical question for a district court in deciding whether to issue a permanent injunction in view of past violation is whether there is a reasonable likelihood that the wrong will be repeated." ^{9/} Such a likelihood may be inferred from the fact of the past violations.^{10/} And this Court, in an opinion post-dating the district court's decision here, has also identified the following factors as significant in the determination whether to grant or withhold injunctive relief:

"the degree of scienter involved, the sincerity of defendant's assurances against future violations, the isolated or recurrent nature of the infraction, defendant's recognition of the wrongful nature of his conduct, and the likelihood, because of defendant's professional occupation, that future violations might occur." Securities and Exchange Commission v. Universal Major Industries Corp., 546 F.2d 1044, 1048 (1976).

^{9/} Securities and Exchange Commission v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1100. Accord, Securities and Exchange Commission v. Management Dynamics, Inc., 515 F.2d 801, 807 (C.A. 2, 1975); Tanzer v. Huffines, 408 F.2d 42, 43 n. 1 (C.A. 3, 1969); Securities and Exchange Commission v. Keller Corp., 323 F.2d 397, 402 (C.A. 7, 1963); Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission, 285 F.2d 162, 180-181 (C.A. 9, 1960), certiorari denied, 366 U.S. 919 (1961); Securities and Exchange Commission v. Boren, 283 F.2d 312, 313 (C.A. 2, 1960).

^{10/} Securities and Exchange Commission v. Management Dynamics, Inc., supra, 515 F.2d at 807; Securities and Exchange Commission v. Shapiro, 494 F.2d 1301, 1308 (C.A. 2, 1974); Securities and Exchange Commission v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1100; Securities and Exchange Commission v. Culpepper, 270 F.2d 241, 249-250 (C.A. 2, 1959).

When the record in this case is examined in relation to these factors, the inference of a reasonable likelihood of future violations of the federal securities laws is patent. Two elements particularly stand out: (1) Somekh's refusal to recognize the nature of his conduct or candidly to describe the operative events in his testimony before the district court, and (2) the intentional and calculated manner in which these violations were committed.

1. Somekh's testimony in the court below

The violations which the district court found resulted from the defendants' failure to set forth a complete and accurate account of the circumstances surrounding Parklane's transformation from public to private status. Given the nature of those violations, we believe that Somekh's candor concerning that subject in his testimony before the district court is a significant guide to his propensity to engage in securities law violations involving deception and nondisclosure in the future.

The Court of Appeals for the Eighth Circuit, like this Court in Universal Major Industries, supra, has stated, in discussing the inference that past wrongs may give rise to the expectation of future misconduct, that the "inference is even stronger when the wrongdoers insist that their actions are legitimate and do not violate the Act." 11/ In this case, Somekh

11/ Securities and Exchange Commission v. First American Bank & Trust, Co., 481 F.2d 673, 682 (1973). See Walling v. Helmerich & Payne, Inc., 323 U.S. 37, 43 (1944); Securities and Exchange Commission v. MacElvain, 417 F.2d 1134 (C.A. 5, 1969), certiorari denied, 397 U.S. 972 (1970). See also Otis & Co., v. Securities and Exchange Commission, 106 F.2d 579, 584 (C.A. 6, 1939):

"From such repeated unlawful acts, we think the inference is legitimate that a like course of conduct might be continued or resumed and this probability is greatly increased by the fact that appellant has expressly asserted and vigorously defended the legality of its challenged activities" (emphasis supplied).

not only has denied all wrongdoing, but has persisted in offering a factual account which did not square with the balance of the evidence presented in the court below. In reaching his decision with respect to the violations which the defendants were found to have committed, the district judge rejected the veracity of Somekh's denials and purported explanations on almost every important point in this case. We believe that he erred, however, in failing to weigh that factor in considering the need for prospective relief.

Mr. Somekh repeatedly denied that his personal debts had anything whatsoever to do with his plan to go private. 12/ The following colloquy is only one of the several times that Mr. Somekh played out his theme of denial: 13/

"Q. Isn't it a fact, Mr. Somekh, that by May 1974 the only way you could pay off your bank loan was to bring Parklane private, use Parklane money to reduce your loans?

* * *

A. It definitely is not a fact, Mr. Garmansky:
[Commission counsel].

Q. Did your personal financial situation play any role whatsoever in your decision to bring Parklane back to the status of a privately owned company?

A. Outside of the fact that it may benefit me, sir, no." (A163)

The balance of the record before the trial court rendered Somekh's assertions incredible. Thus, Bankers Trust vice-president Baggott, who had

12/ Not only did Somekh deny that his plans for eliminating the public shareholders were influenced by his personal loan situation, he denied aspects of his personal financial condition until the introduction of his prior investigatory testimony to the contrary made continued denials untenable (A141).

13/ See also, A158, A203, A434, A437.

no personal interest in this litigation, testified about a conversation with Somekh in August, 1974 concerning the reasons for the change in Parklane's status:

"A. Mr. Somekh told us they had decided to go private as a means of liquidating the personal obligation and they told us roughly of the plan, how it would work and so forth.

"The Court: What exactly did he say?

"The Witness: He said they had decided to go private and in doing so they would take, buy up the outside stockholdings. They would take and sell some of his personal properties to the new private company to be and in that way, be able to pay us back out of the new company to be, the balance of the personal secured loan." (A89 - A90) 14/

Despite Somekh's emphatic denials, the district court found:

"It is clear to me that the overriding purpose for the merger was to enable Somekh to repay his personal indebtedness. Had his finances been otherwise, the merger may never have occurred." (422 F. Supp. at 482; A13)

Similarly, with respect to the FRB negotiations, Somekh repeated his litany of denial. In discussing the October 4 meeting with Curtiss (FRB's agent), Somekh denied that he had represented that the Nassau Street leasehold could be cancelled for \$1.2 million; denied that he could get an extension of the sub-tenant's willingness to accept \$600,000 for its interest; denied that Curtiss told him that he would place the counter-offer before FRB; and, in general, even denied that his conversation could be considered "negotiation" at all (A250, A253, A254). Curtiss contradicted Somekh's

14/ When asked about his version of this conversation, Somekh's response was less than forthright. See A207 - 208. Ultimately, he stated,

"I am saying if what you are telling me was a sequence of events, and if this kind of conversation took place, I am suggesting what I may have said." (A208)

denials, as the following excerpt from Curtiss's testimony illustrates:

"The Court: Somehow or other you and Mr. Somekh came up with a figure of one million two?

"The Witness [Curtiss]: That's correct.

"The Court: After you came up with the figure, who said what to whom then? What did say to him?

"The Witness: I said I am going to recommend payment of a million two and you get me assurance that you can settle your end of it for that amount.

"The Court: When you say 'your end of it'—

"The Witness: The other two parties involved." (A343 - A344)

Somekh's testimony denying the progress in the FRB negotiations was further contradicted by Somekh's own letter to Baggott, written soon after that meeting, in which he stated:

"Also, and again this is off the record since until I have the money in my hand, I don't want to say that I have any deals, but I have had several conversations with the Federal Reserve and it seems that we may be heading towards a deal that would net Parklane \$300,000 that can close around the end of the year. I am keeping my fingers crossed since I realize what this would mean so let's both hope it gets done." (A575) 15/

The district court, after hearing the evidence, rejected Somekh's version:

"I find that the October 4 conference between Somekh and the authorized representative of the FRB falls within the common usage of the term negotiation. Thus, the unamended proxy material was false when it stated that there are no negotiations at present." 422 F. Supp. at 483; A16.

15/ When this letter (Pl. Ex. 33, A575) was introduced in the district court, Somekh was asked whether it was accurate. We believe that his response is illustrative of his general attitude:

Q. But at the time you wrote Plaintiff's Exhibit 33, did you believe the statements to be accurate?

A. I am not so sure that I really thought about it, outside of dictating it in a machine and probably going away, but upon reflection now, I would say that it is not." (A257)

Finally, the same pattern of uncredited denials was repeated with respect to the allegations concerning the Thomson & McKinnon appraisal. Somekh assured the district court that he had provided "whatever information the appraisers might require" (A437), but was contradicted by the weight of the evidence. For example, the appraiser himself testified:

"Q. Mr. Russ, did you know at the time you applied your various techniques that approximately \$1 million in corporate assets were to be used by Mr. Somekh to reduce his personal indebtedness?

* * *

"A. No, I was not aware of that.

* * *

"The Court: At the time that you made this appraisal, did you realize that as soon as the company went private, some of its assets would be tied up in land?

"A. No.

* * *

"Q. At the time you performed your appraisal, did you know that the company was negotiating for the cancellation of its leasehold in Nassau Street, New York?

"A. No, I did not." (A306, A307, A308)

The court chose to credit the appraiser's testimony:

"The failure to inform Thomson & McKinnon of these facts and the failure to disclose the defect in the appraisal in the proxy statement is beyond question" (422 F. Supp. at 484; A17).

Somekh's inability or unwillingness to recognize even the factual context in which the violations found below arose offers little assurance that he will be able or willing to endeavor to avoid further violations. We believe that this record of equivocation and denial strongly suggests the need for the incentive of an injunctive order to encourage greater sensitivity to the requirements of law in the future.

2. The intentional nature of Somekh's conduct

This Court has stated, in Universal Major Industries, supra, 546 F.2d at 1048, that the nature of the violation and the degree of scienter involved are significant factors in evaluating the need for injunctive relief. The district court found that Somekh's violations were "knowing" (422 F. Supp. at 487; A26), a finding, we submit, scarcely open to serious question. Moreover, the violations cannot be said to be merely technical. Regulation of the proxy solicitation process is crucial to the discharge of the Commission's mandate under the Securities Exchange Act of 1934 to insure that investors are fully informed concerning the financial condition and management stewardship of business ventures which rely on capital obtained from the public at large.^{16/} Pursuant to the authority in Section 14(a) of the Act, the Commission has evolved pervasive rules which reflect one of "the major accomplishments flowing from the 1934 Act for the benefit of the investing public and the market place generally."^{17/} As one commentator has stated: "The proxy rules are very likely the most effective disclosure device in the SEC scheme of things." ^{18/}

^{16/} See S. Rep. No. 792, 73d Cong., 2d Sess. at 12 (1934); H.R. Rep. No. 1383, 73d Cong. 2d Sess. at 13-14 (1934). The House Report on the proxy solicitation provisions of the Securities Exchange Act of 1934 makes an observation which is apt in light of Somekh's conduct in the present case:

"Insiders have at times solicited proxies without fairly informing the stockholders of the purposes for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights."
H.R. Rep. No. 1383, supra, at 14.

^{17/} House Committee on Interstate and Foreign Commerce, Hearings on H.R. 6789, H.R. 6793, S. 1642, 88th Cong., 1st & 2d Sess. 165 (1964).

^{18/} 2 Loss, Securities Regulation, 1027 (2d ed., 1961).

The seriousness of the defendant's violations -- an essential link in defendant Somekh's plan to alter Parklane's corporate status for his own ends 19/ -- becomes evident when examined from the viewpoint of the public shareholders of Parklane. In essence, these shareholders were suddenly forced to put a dollar value on their holding in order to make the critical choice between accepting the cash offer of the company, taking a chance on an appraisal proceeding, or suing in state court to enjoin the proposed merger.20/ And yet that choice, because of the "knowing" fraud of the defendants, was made without the benefit of several pieces of important information -- namely, the true reason for the conversion of Parklane to privately-held status;

19/ As noted, the Commission did not allege that Somekh's plan to convert Parklane to private status in itself constituted a violation of the federal securities laws. That does not mean, however, that Somekh's scheme is irrelevant to the issue at hand. The record in this case is replete with references to this central transaction, and it is to this record that this Court must look in evaluating the district court's refusal to grant injunctive relief.

20/ Had Somekh fully disclosed the "overriding purpose" (422 F. Supp. at 482; A13) for the going private plan -- that is, to take care of his personal financial situation -- the merger could well have been enjoined under state law as being undertaken for no valid corporate purpose. In People v. Concord Fabrics, Inc., 371 N.Y.S. 2d 550 (Sup. Ct., 1975), affirmed, 373 N.Y.S. 2d 84 (App. Div. 1st Dept., 1976), the New York courts held that the Attorney General of the state could investigate and seek to enjoin proposed freeze-out mergers. The facts of that case are similar to those in this case:

"What is disquietingly evident here is the fact that a group of insiders who are directing the reacquisition programs, even controlling the appraisal of the stock, are the very ones who made the company public originally, and will be the surviving shareholders in the proposed privately-held enterprise. Adding to the odium of the scheme is the fact that no real corporate purpose has been demonstrated and that the credit of a now public corporation will be used to finance a merger for the benefit of a private group." 371 N.Y.S. 2d at 554

the real status of negotiations between Parklane and FRB; and, finally, the fact that the independent appraisal of Parklane stock cited in the proxy (an appraisal which would reasonably be expected to mirror the results of any appraisal proceeding instituted by dissenters under state law) was based upon inadequate and incomplete information available to the appraiser.

Thus, this case entails a carefully constructed plan, dependent for its success upon violations of the Commission's proxy solicitation rules, and motivated only by a desire to enrich the plan's architect. Where violative conduct is so consciously undertaken, as it was here, we believe that injunctive relief is clearly indicated.

B. The District Court Misjudged the Probability of Future Violations.

The Commission recognizes that the standard which it must meet in establishing that injunctive relief was improperly withheld is the abuse of discretion standard, and that the burden which that test imposes is substantial.^{21/} The application of the standard must, however, be judged in light of the circumstance of this case. ^{22/} The Supreme Court has emphasized that,

^{21/} But see NMU v. Commerce Tankers Corp., 457 F.2d 1127, 1133 (C.A. 2, 1972):

"Were this an appeal from the grant after an evidentiary hearing of [an] injunction our scope of inquiry could be limited by the 'clearly erroneous' test. However, when the appeal is from the denial of a petition for [an] injunction, it seems that, in light of the congressional policy favoring the grant of such injunctions in appropriate circumstances, our scope of review ought not to be so limited" (emphasis that of the Court).

^{22/} See, e.g., Securities and Exchange Commission v. Management Dynamics, Inc., supra, 515 F. 2d at 808, where this Court stated:

"Unlike private actions, which are rooted wholly in the equity jurisdiction of the federal court, SEC suits for injunctions are 'creatures of statute.' '[P]roof of irreparable injury or the inadequacy of other remedies as in the usual suit for injunction' is not required. * * *

(footnote continued)

in the case of relief sought to prevent further violations of a remedial federal statute:

"The courts have an obligation, once a violation * * * has been established, to protect the public from a continuation of the harmful and unlawful activities."
United States v. Parke, Davis & Co., 362 U.S. 29, 48 (1960).

And in Mitchell v. Pidcock, 299 F.2d 281, 287 (C.A. 5, 1962), the Fifth Circuit, enforcing another federal remedial statute, the Fair Labor Standards Act, pointed out that the injunctive proceeding is "only superficially related to a suit in equity for an injunction to protect interests jeopardized in a private controversy." The court continued:

"The injunctive processes are a means of effecting general compliance with national policy as expressed by Congress, a public policy judges too must carry out — actuated by the spirit of the law and not begrudgingly as if it were a newly imposed fiat of a presidium.

* * *

"We do not say or imply that injunctions should be issued freely, without regard for the facts, simply because it is the Government asking for the injunction. We say that the manifest difficulty of the Government's inspecting, investigating, and litigating every complaint of a violation weighs

22/ (footnote continued)

* * *

"It requires little elaboration to make the point that the Securities and Exchange Commission appears in these proceedings not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws."

Accord, Securities and Exchange Commission v. Advance Growth Capital Corp., 470 F.2d 40, 53 (C.A. 7, 1972); United States v. Diapulse Corp. of America, 457 F. 2d 25, 28 (C.A. 2, 1972); Securities and Exchange Commission v. Tax Service, Inc., 357 F. 2d 143, 145 (C.A. 4, 1966); Bradford v. Securities and Exchange Commission, 278 F.2d 566, 567 (C.A. 9, 1960).

heavily in favor of enforcement by injunction -- after the court has found an unquestionable violation of the Act." (299 F. 2d, at 287; emphasis in the original).^{23/}

In the context of the securities laws, the Supreme Court has repeatedly stressed that those laws, as remedial legislation, should be construed "flexibly," "not technically and restrictively,"^{24/} and that the federal courts should be "alert to provide such remedies as are necessary to make effective the Congressional purpose." ^{25/}

^{23/} See also United States v. Diapulse Corporation of America, 457 F.2d 25, 27-28 (C.A. 2, 1972):

"But the function of a court in deciding whether to issue an injunction authorized by a statute of the United States to enforce and implement Congressional policy is a different one from that of the court when weighing claims of two private litigants * * * .

"The passage of the statute is, in a sense, an implied finding that violations will harm the public and ought, if necessary, be restrained * * * ."

Even where the litigation does involve "weighing claims of two private litigants," public interest considerations akin to those involved in government cases will tip the balance in favor of injunctive relief. See Gulf & Western Industries, Inc. v. Great Atlantic & Pacific Tea Companies, Inc., 476 F.2d 687, 699 (C.A. 2, 1973) where this Court, in unanimously affirming the district court's grant of a preliminary injunction which enjoined consummation of a tender offer because of alleged violations, inter alia, of Section 14(e) of the 1934 Act, stated:

"Therefore, as in actions brought by the government, doubts as to whether an injunction sought is necessary to safeguard the public interest -- when the public interest involved is as clear, pervasive and vital as the record here demonstrates -- should be resolved in favor of granting the injunction. See, United States v. First National City Bank, 379 U.S. 378, 383 (1965); Mitchell v. Piddcock, 299 F.2d 281, 287 (5 Cir. 1962)."

^{24/} Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

^{25/} J.I. Case Co. v. Borak, 377 U.S. 426, 433 (1964). See Mills v. Electric Auto-Lite Co., 396 U.S. 375, 391 (1970).

The district court's decision to withhold injunctive relief -- despite its unequivocal findings that serious violations had occurred -- must be evaluated in the light of these principles. In contrast to its unwillingness to credit in any way Somekh's testimony regarding the facts, the court below apparently chose to give both defendants the benefit of the doubt on the question of entering injunctive relief. In reaching that result, the trial court seems to have relied upon two factors -- the fact that Somekh was not a securities broker or dealer (422 F. Supp. at 487, A23) and the fact that, in the court's view, the deception practiced in the Parklane merger was an "isolated occurrence" (422 F. Supp. at 487, A23). While reference to these factors was not improper, we do not believe that either was of sufficient substance, on the facts of this case, to outweigh the need for injunctive relief evidenced by Somekh's calculated scheme to deceive Parklane's public shareholders and his tenacious refusal to acknowledge the substance of that scheme.

The significance of the court's observation that Somekh is not a securities broker or dealer is unclear. It may be true that persons in occupations directly regulated by the Commission are more likely to run afoul of the securities laws than those in other occupations. But reliance on that rationale, alone, would vitiate the Commission's ability to enforce the securities laws against a wide range of persons. In the case of those who exercise control over corporations to which the public has entrusted its funds, civil injunctions are the primary enforcement device on which the Commission relies.^{26/}

^{26/} The Commission can, of course, also recommend to the Justice Department that it pursue a criminal action against willful violators of the federal securities laws. See, e.g., Section 32 of the Securities Exchange Act, 15 U.S.C. 78ff. As a practical matter, however, civil injunctive actions are the chief means of insuring that the public is protected against repeated misconduct by those who have previously violated the securities laws. For example, in fiscal year 1975, 174 injunctive actions were instituted by the Commission, as opposed to 53 criminal indictments returned. See Annual Report of the Securities and Exchange Commission, Tables 28, 29 (1975).

The records of the courts in this and other circuits are replete with injunctions entered against persons, other than brokers or dealers, who have committed fraud in connection with securities transactions. Here, Somekh used his control over Parklane to deceive the public shareholders of that corporation for his own pecuniary gain, and he continues to occupy that same position at Parklane today.^{27/} Moreover, Somekh's interests go beyond Parklane as he is an investor in a variety of ventures. An injunction restraining him from violations of the securities laws would serve to assure that his conduct in those ventures, to the extent that it relates to securities, is free of the fraud that characterized the instant venture.

The second factor deemed controlling by the court below -- that the freeze-out of Parklane's public investors was an "isolated" occurrence -- is equally unsatisfactory in light of the facts of this case. A violator might plausibly ask a court to assume that his transgression was an isolated

^{27/} It is true that Somekh's position has changed somewhat by virtue of the metamorphosis of Parklane's corporate status. But even where a past violator has severed all connection with the entity he used for his violative scheme, an injunction is proper. See, e.g., Securities and Exchange Commission v. Midwest Technical Development Corp., [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,252 (D. Minn., 1963), where the court stated (id. at p. 94,153):

"As noted heretofore, certain defendant directors are no longer members of the Board of Midwest and were not when this suit was commenced. * * * The question arises as to whether these defendants * * * should be subject to any injunctive relief entitled therein in behalf of the Commission.* * * [T]he mere fact that these defendants are no longer directors does not render them immune from injunctive orders as to transactions which occurred when they were serving as directors of Midwest and in which they are responsible under the Act."

occurrence when that violation was found to have been merely inadvertant or negligent. 28/ But where, as here, the defendant has been found to be a knowing violator of the securities laws, such an assumption flies in the face of the well-established principle that a likelihood of future violations may be inferred from the fact of past violations.29/ Similarly, that assumption ignores the rationale behind the equally well-established proposition that a court may justifiably frame injunctive relief so as to prevent future violations of the antifraud provisions of the federal securities laws whether or not those violations are likely to result from a repetition of the same conduct previously alleged and proved. 30/

28/ See Securities and Exchange Commission v. Management Dynamics, *supra*, 515 F.2d at 809, where the Court, in discussing the propriety of injunctive relief stated:

"Thus, the district court's conclusion that Levy's action was not 'inadvertant' is not erroneous, and the record demonstrates at least that degree of negligence which suffices for the grant of injunctive relief in SEC enforcement actions."

The Court in that case went on to state (*id.* at 809, n.5):

"We need not delineate the precise standards for those cases in which the fact of violation and the likelihood of future infractions are not as clear as in the case at bar. Suffice to say in such cases the district court will attach greater weight to traditional equity principles in arriving at its conclusion."

29/ See n.9, *supra*. See also Securities and Exchange Commission v. Shapiro, *supra*, 494 F.2d at 1308: "'[F]irst offenders' are not immune from injunctive relief."

30/ In evaluating the likelihood that a fraud-feasor will again engage in fraudulent conduct, the limitless possible variations of the offense must be recognized. As the Supreme Court has pointed out in Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193, n.41 (1963), quoting Lord Harwicke's letter to Lord Kames (1759):

"Fraud is infinite, and were a Court of Equity once to lay down rules, how far they would go, and no further, in extending their relief against it, or

(footnote continued)

In Securities and Exchange Commission v. North American Research & Development Co., 375 F. Supp. 465 (S.D.N.Y., 1974), the court, in considering the proper scope of relief for established violations of the securities laws, observed that "the defendants' past actions and their pervasive conduct with respect to North American, which furnishes a clue to their general attitudes, justify such relief."^{31/} Similarly here, the record abounds with clues about Somekh's general attitudes. See pp. 19-23, supra. We do not believe that a knowing violator of the law is entitled to any presumption that his intentional misconduct was an isolated occurrence.

Moreover, even if the "isolated occurrence" rationale were entitled to some weight, that weight must be balanced against the mild nature of the relief which the Commission is seeking. The federal courts have recognized that the injunctive remedy is a "mild prophylactic" issued to effectuate the important goals of the federal securities laws.^{32/} As Chief Judge Kaufman has observed:

"I fail to see any injury resulting to defendant by the granting of this injunction. As was stated in Securities

^{30/} (footnote continued)

to define strictly the species or evidence of it, the jurisdiction would be cramped, and perpetually eluded by new schemes which the fertility of man's invention would contrive."

See also State v. Whittaker, 118 Ore. 656, 661, 247 P. 1077, 1079 (1926); Stonemets v. Head, 248 Mo. 243, 263, 154 S.W. 108, 114 (1913) ("Fraud is kaleidoscopic, infinite * * * and tak[es] on protean form at will * * *").

^{31/} See Securities and Exchange Commission v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1102; Hillsborough Investment Corp. v. Securities and Exchange Commission, 276 F.2d 665, 667 (C.A. 1, 1960). Cf. NLRB v. Express Publishing Co., 312 U.S. 426, 435, 437 (1941).

^{32/} Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., supra, 375 U.S. at 193. See also Securities and Exchange Commission v. Geon Industries, Inc., 531 F. 2d 39, 56 (C.A. 2, 1976); Securities and Exchange Commission v. Manor Nursing Centers, supra, 458 F. 2d at 1096; Mitchell v. Pidcock, supra, 299 F. 2d at 287; Securities and Exchange Commission v. Scott, Gorman Municipals, Inc., 407 F. Supp. 1383, 1387 (S.D. N.Y., 1975); Securities and Exchange Commission v. Graye, 156 F. Supp. 544, 547 (S.D. N.Y., 1957).

and Exchange Commission v. Otis, D.C. Ohio, 1936, 18 F. Supp. 100, 101, affirmed, Otis v. Securities and Exchange Commission, 6 Cir., 1939, 106 F.2d 579; 'If in fact defendant has no intention of again offending, it will not be injured by an injunction.' The injunction does not seek to put defendant out of business. It seeks only to restrain him from doing business while he is in violation of the S.E.C. rules. It does not seek to harm defendant, but rather to protect the public. Compliance will mean continuation." Securities and Exchange Commission v. Graye, supra, 156 F. Supp. at 547 (S.D. N.Y., 1957).

Time may perhaps prove the district judge right and defendants, even if not enjoined, may elect to refrain from further violations of the federal securities laws. Judging by their past conduct, however, we do not believe that the investing public should be required to run this risk nor should the Commission be required to risk the need again to devote a substantial share of its limited enforcement resources to their apprehension. "Surely the Commission should not be required to keep these appellants under surveillance and to bring a subsequent injunction action if they commence again to [violate the federal securities laws]." Securities and Exchange Commission v. Culpepper, 270 F.2d 241, 250 (C.A. 2, 1959).

CONCLUSION

For the reasons stated herein, we respectfully urge that the decision of the district court to deny prospective relief be reversed and that a permanent injunction be entered against further violations of the provisions of the federal securities laws which defendants have been adjudged to have violated.

PAUL GONSON
Associate General Counsel

DANIEL L. GOELZER
Special Counsel

EDWARD A. SCALLET
Attorney

April, 1977

Securities and Exchange Commission
Washington, D.C. 20549



OFFICE OF THE
GENERAL COUNSEL

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

May 5, 1977

A. Daniel Fusaro
Clerk
United States Court of Appeals
for the Second Circuit
United States Courthouse
Foley Square
New York, New York 10007

Re: Securities and Exchange Commission v. Parklane Hosiery Co.,
Inc., et al., No. 77-6012

Dear Mr. Fusaro:

On Friday, April 29, 1977, I transmitted for filing four copies of the page-proof Brief of the Securities and Exchange Commission in the above-captioned case. Enclosed for filing herewith are ten copies of the final printed Brief of the Securities and Exchange Commission.

In addition, I hereby certify that, on this same day, I caused a copy of the final printed Brief to be sent to counsel for defendants.

Sincerely,

Edward A. Scallet

Edward A. Scallet
Attorney

cc: Counsel for Defendants
Irving Parker, Esquire
Jacobs, Persinger & Parker
70 Pine Street
New York, New York 10005

Scallet

5-4-77